New York Independent System Operator, Inc. Docket No. ER00-1969-000

Niagara Mohawk Power Corporation
v. Docket No. EL00-57-000
New York Independent System Operator

Orion Power New York GP, Inc.
v. Docket No. EL00-60-000
New York Independent System Operator, Inc.

New York State Electric & Gas Corporation
v. Docket No. EL00-63-000
New York Independent System Operator, Inc.

Rochester Gas & Electric Corporation
v. Docket No. EL00-64-000
New York Independent System Operator, Inc.

(Issued May 31, 2000)

HÉBERT, Commissioner *concurring*:

The Commission here takes an important step toward establishing a truly competitive electricity market. In several ways, FERC departs from past practices. Today's order does not pretend that the New York Independent System Operator (ISO) designed a competitive market for operating reserves. Today's order does not pretend that any utility, singly or in combination, *exercised* market power. (In fact, we explicitly refuse to make that finding. Slip op. at 12.) Today's order does not pretend that *owning* a large portion of the capacity in a market amounts to anti-competitive activity. Finally, today's order does not pretend to take the approach contained in the ISO's request. Unlike in the past, we decline to reconstruct a competitive market through price or bid caps until the allegedly anti-competitive behavior ceases.

Instead, we all agree that New York faces a systemic problem with the rules and procedures of the ISO. Slip op. at 13-14. We agree the problem needs a solution. We agree that the ISO must fix five features of its procurement policies, and that it must do so soon. We further agree that in the interim we will supplant the reserve market currently in disrepair with a form of cost-based regulation. Finally, we agree that, if the problem remains beyond November 1, we will take further, appropriate steps, including a possible proceeding against the ISO under section 206 of the Federal Power Act.

On today's record, and, as we will soon see, the record in a related complaint, the ISO failed in its responsibilities. I think we should reconsider our approval of the organization as the operator of the grid in New York. I prefer we institute a section 206 proceeding against the ISO directly, rather than wait for the further report due on June 30. Slip op. at 31. Therefore, I concur.

*Not Ready for Prime Time*

Elementary economics teaches that businesses in a free market, unlike regulators, set prices according to customer value (what the buyer finds it worth paying), not the sellers' cost recovery. Generators submitting bids that would earn profits show the market at work, not manipulation, or "gaming," to use the currently popular term. Economics recognizes that, in addition to the forces of supply and demand, buyer ineptitude can lead to high prices, though set at inefficient levels.

The Commission has learned these lessons. Here, we state, slip op. at 12, that we make no finding that any generator withheld capacity. Instead, we find that buyer error by the ISO created the conditions for the severe breakdown of the reserve market that the order recites. Slip op. at 13-14. In particular, we identify the following mistakes -- basic ones, in my opinion -- the ISO made in organizing the reserve market.

- The ISO restricted the market when it "insisted" on purchasing from the east, though the path from the west remained open (91 FERC at , slip op. at 14);

- The ISO failed to set aside transmission capacity to buy from the west to keep open the path (*id.)*;

- The ISO further restricted the market, as the operator failed to include a large hydroelectric facility in its list of available sources, even though "[i]f this unit were included, it could significantly change the market concentration and add another large competitor to the market." (*id*.);

- The ISO restricted the market even further by adopting practices that "severely limit the ability of customers . . . to self-supply operating reserves," though "[s]elf-supply is an important option to mitigate the potential exercise of market power." (91 FERC at , Slip op. at 15); and, I would add,

- The ISO kept prices high by applying to the spinning (stand-by) reserve market the higher prices in the non-spinning (not immediately available) reserve market, on the excuse that bidders would otherwise flock to the non-spinning reserve market. 91 FERC at , Slip op. at 27. Of course, this ignores the fact that more bids in non-spinning reserves would bring the price down.

*Teaching the Fundamentals*

I consider price controls a device that enables undisciplined behavior and avoidance of hard choices. I would give the ISO the cold turkey treatment, in one of two ways. I would reject the bid caps altogether and let the prices fluctuate. This would act as an inducement to the ISO to reform its practices. Each of the errors the ISO made it could repair in short order. In fact, I understand that just one measure, including the hydroelectric project in the calculation will relieve the "crisis" here. While the ISO's software created the difficulty, systems exist that work and the ISO can install them. Alternatively, the ISO could purchase from the west and allow utilities to supply their own reserves. These changes the ISO can order immediately. With bid caps in place, it has no incentive to spend the money or change its practices. Without bid caps, the ISO will find the necessary time and money to do so.

The other method to fix the problem, on a long-term basis, requires that, in drastic cases, we substitute traditional regulation for the short term. Today's order adopts that solution. We state, 91 FERC at , slip op. at 18-19, that we adopt a proxy for capacity costs, and allow generators to recover more, if they show us that they incurred higher expenses. Then, we adopt opportunity costs (lost sales) as a proxy for energy costs. With traditional regulation, in effect, we supplant the ISO, until November 1, when we order it to change the way the New York reserve market operates .

*Conclusion*

As I stated at the outset, I agree that New York faces a potentially difficult summer. The problem lies in the failure of the participants to construct a market. I would agree, therefore, to start from the beginning. I would institute a proceeding under section 206 of the Federal Power Act, to withdraw our approval of the New York ISO, either here, or in the related case we will soon consider. This will allow everyone to deal with the reality of the failure of the parties in New York. With the deadlines of Order No. 2000 looming, this will give an impetus to the industry there to construct from the ashes of the current system, a real competitive market within the framework of a regional transmission organization.

Today's order, though not as explicit as I would write it, begins that journey. Readers should take away from our action the message that we will enforce standards on existing ISO's to ensure the proper framework for competition. We will direct solutions to systemic problems, as we do today. Though we will not institute a proceeding under section 206 now, the Commission stands ready to take tough action, even against existing ISO's. Complacent ISO's will not obtain approval as RTO's under Order No. 2000. We may not even allow them to continue in operation, stumbling from season to season and year to year, distinguished only by their talent for self-preservation.

I hope the ISO will act to make the next step unnecessary. Today's order, at least, shows our resolve. I concur.

Curt L. Hébert, Jr.
Commissioner